Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review For Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operation Services Under Price Cap Rules for AT&T	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

REPLY COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

David R. Poe
Brian T. FitzGerald
LeBOEUF, LAMB, GREENE & MacRAE, L.L.P.
1875 Connecticut Avenue, N.W.
Washington, DC 20009-5728
TEL: (202) 986-8000

Attorneys for Time Warner Communications Holdings, Inc.

Paul B. Jones, Esq.
Janis Stahlhut
Donald F. Shepheard
Time Warner Communications Holdings, Inc.
300 First Stamford Place
Stamford, Connecticut 06902-6732

Economic Consultants:
Dr. Lee L. Selwyn
Susan M. Baldwin
Economics and Technology, Inc.
One Washington Mall
Boston, Massachusetts 02108
TEL: (617) 227-0900

Date: January 16, 1996

TABLE OF CONTENTS

SUMMARY

In its December 11, 1995 comments in the pending Second Further Notice of Proposed Rulemaking issued on September 20, 1995,[1] Time Warner Communications Holdings, Inc. ("TW Comm") articulated its strong opposition to the Federal Communications Commission's ("Commission") proposal to modify its current price cap plan. In their comments, however, the local exchange carriers ("LECs") conveniently maintain that downward pricing flexibility and relaxed regulation would be in the public interest, by arguing that they will facilitate lower prices. In reality, however, such proposed pricing flexibility would only create new opportunities for the LECs to engage in anticompetitive conduct. At this time, there is simply no incentive for the LECs to lower prices in markets where the LEC is the monopoly provider. In markets where competition is emerging, pricing flexibility may result in predatory pricing by the LEC, thereby thwarting the development of competition. Thus, absent compelling incentives to comply, LECs can be expected to delay and frustrate efforts by competitors to enter and compete in LEC-dominated markets.

Although the LECs claim to support competition, TW Comm has experienced first-hand LEC stonewalling tactics demonstrating a willingness to impede, rather than promote, competition.

---

1 In re Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 95-393 (Sept. 20, 1995).

Allowing LECs to take advantage of reduced regulatory requirements will result in the erosion of nascent competition rather than erosion of LECs' current market power.

As stated in its initial comments, TW Comm supports the Commission's proposal to implement a competitive checklist to evaluate competitive conditions. However, due to the challenges associated with developing a comprehensive checklist, TW Comm recommends that the Commission issue a Notice of Proposed Rulemaking to more carefully hone such a list.

The LECs argue that if all items on the checklist are addressed and competition still fails, the failure will be due to their efficiency in providing service and not because competitors would have been denied an opportunity to compete. Such a presumption, however, would be unreasonable since relying merely on a checklist does not take into consideration or resolve all ongoing day-to-day issues that can affect a new entrant's ability to compete. Rather, the only accurate means for assessing the validity of such a checklist is to measure its effectiveness in permitting actual competition to develop and prosper. Thus, market share must be considered in conjunction with a competitive checklist to determine the actual presence of competition.

The Commission's priority should be the orderly transition to competitive markets for local services rather than deregulation of LECs.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review For Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operation Services Under Price Cap Rules for AT&T	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

REPLY COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

INTRODUCTION

Time Warner Communication Holdings, Inc. ("TW Comm") urges the Federal Communications Commission ("FCC" or "Commission") to heed the warnings of the many commenters regarding the severe risks associated with the unwarranted and premature relaxation of the existing provisions of the price cap system. In these Reply Comments, TW Comm addresses several major thematic areas, which should be considered in tandem with the detailed discussion of the numerous issues that TW Comm provided in its initial Comments.[1]

TW Comm continues to be troubled by the apparent assumption in the Commission's FNPRM[2] that the incumbent local

---

[1] Initial Comments of Time Warner Communications Holdings, Inc., filed in the referenced docket on December 16, 1995 ("TW Comm's Comments").

[2] In re Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking, CC

(continued...)

exchange carriers ("LECs") — given additional pricing flexibility before there is any evidence of sufficient competition — will behave in a manner that promotes the public interest and furthers the Commission's goal of encouraging the development of economically efficient competition in the local market. In their initial comments, the LECs are asking the Commission to trust the incumbent carriers to engage in behavior that would be fundamentally irrational and at odds with their own economic self-interest. That is, the Commission would be expecting the LECs to refrain from attempting to maximize their profits by foregoing pricing strategies in which rates for competitive services are decreased while those for services without competitive alternatives are raised to the maximum permissible level.

The underpinnings of any theory of economic regulation is that firms will pursue their economic self-interest, and that the regulatory system should be designed so as to channel such efforts in economically efficient and socially desirable directions.[3] A method of regulation that relies upon the

---

[2](...continued)
Docket No. 94-1, FCC-93-393 (Sept. 20, 1995) (hereinafter "<u>LEC Pricing Flexibility NPRM</u>" or "<u>FNPRM</u>").

[3] LEC positions in the various price cap notices confirm the LECs' pursuit of their own self interest. In the instant FNPRM, the LECs are seeking removal of all downward price restrictions and the flexibility to geographically deaverage rates. Concurrently, in the Commission's Fourth Notice of Proposed Rulemaking in this proceeding, LECs also seek to drastically reduce the productivity factor and eliminate any earnings limitations with sharing requirements. <u>See</u> In re Price Cap Performance Review for Local Exchange Carriers, <u>Fourth Notice of Proposed Rulemaking</u>, CC Docket No. 94-1, FCC 95-406 (September 27, 1995). LEC motives should be abundantly clear. They simply have no interest whatsoever in reducing rates as a response to competition without (continued...)

regulated firm to refrain from pursuing its own self-interests is at best a conceptual contradiction, and at worst a virtual guarantee of failure.

The pervasive theme in the LECs' comments is that the market is "contestable" and therefore neither consumers nor competitors will be harmed by lessening regulatory oversight of their prices because competitive local exchange providers ("CLECs") will enter the market and in so doing constrain the monopolistic behavior of the incumbents. The Commission should reject any reliance whatsoever on this misguided application of the theory of contestability. Predictably, the vast majority of the LECs also reject any reliance upon market share as a way to gauge the competitiveness of the market, and the LECs also only recognize the importance of eliminating barriers to entry as it relates to the third and most extreme level of LEC deregulation proposed in the NPRM; i.e., a finding of nondominance.[4] In sharp contrast with these narrow, self-serving views, TW Comm recommends that the Commission affirmatively find that evaluations of market share and competitive checklists which indicate the extent to which entry barriers have been removed are

---

[3](...continued) offsetting such reductions with increases in rates to their captive ratepayers to the maximum extent possible. Such offsetting increases outside of the annual price cap filing are currently limited by the price cap banding constraints. However, if LECs could ensure annual PCI increases, such offsetting rate increases would be guaranteed. With this strategy in mind, it is not surprising that LECs are seeking to secure the lowest possible productivity offset factor and eliminate any potential sharing obligation.

[4] In contrast, NYNEX has presented a plan which represents a major step forward by an RBOC toward recognizing the need to link greater regulatory freedom for LECs to the removal of entry barriers and the development of actual competition.

directly related to all three levels of pricing flexibility proposed in the FNPRM.

Finally, instead of expending its efforts to relax pricing constraints on the LECs, the Commission should focus its efforts to (1) eliminate the numerous barriers to competition, (2) monitor LECs' foot-dragging and anticompetitive behavior, (3) create and impose sanctions for such anticompetitive behavior, and (4) continue to refine a well-structured competitive checklist that should then be used as a threshold measure of the possibility of local competition. For the reasons discussed in these Reply Comments as well as in TW Comm's Comments, compliance by the LECs with such a checklist should be interpreted as a necessary and essential step toward effective competition, but such compliance should not in and of itself be accepted as evidence of actual competition.

I. THE COMMISSION SHOULD NOT GRANT ANY ADDITIONAL PRICING FLEXIBILITY UNTIL SIGNIFICANT HEADWAY HAS BEEN MADE IN REMOVING BARRIERS TO COMPETITION AND ACTUAL COMPETITION EXISTS.

Not surprisingly, the LECs strongly support the Commission's proposal to grant additional pricing flexibility to all price cap LECs without regard to the level of competition that presently exists. The LECs contend that this first level of pricing flexibility, which would among other things allow additional downward pricing flexibility for all price cap LECs, is in the public interest.[5] Indeed, the LECs suggest that the

---

[5] See, e.g., Comments of Southwestern Bell Telephone Company ("SWB"), at 52; Comments of Cincinnati Bell Telephone ("CBT"), at 9-10; Comments of United States Telephone Association ("USTA"), at 10-15; Comments of NYNEX ("NYNEX"), at 18; Comments of Pacific Bell and Nevada Bell ("Pacific Companies"), at 20.

pricing flexibility proposed by the Commission would foster "efficient" pricing "as competition evolves, not only after it has evolved."[6] In a similar vein, a statement prepared on behalf of BellSouth states that "[c]onsumers will benefit and economic efficiency will increase if LECs choose to lower prices, regardless of the level of competition in access or local exchange markets."[7] There are several reasons why the Commission should reject these transparent efforts to clothe pricing flexibility for the LECs with a public interest mantle.

The proposed pricing flexibility would create new opportunities for the LECs to engage in anticompetitive conduct, which would ultimately lead to uneconomic pricing in the marketplace. In considering whether to grant more pricing leeway to the LECs, the Commission should consider the incentives of the LECs and the implications for consumers. In those markets where the LEC is indisputably the monopoly provider, it would be irrational for the LEC to lower prices and thus the additional downward pricing flexibility would be superfluous. In those markets where new entrants may be beginning to serve the market and where the LEC seeks to underprice its potential competitors, the pricing flexibility will simply be used to enable the incumbent carrier to thwart competitive entry because the LEC can sustain a rate reduction in the emerging competitive market by

---

6 SWB, at 51. <u>See</u> Comments of Bell South Telecommunications, Inc. ("Bell South"), at 3-4. <u>See also</u> Pacific Companies, at 32 ("price cap reforms that we propose may be justified entirely on the basis of more closely aligning rates with costs and market conditions — one of the fundamental principles of price cap regulation").

7 Bell South, Appendix (hereinafter "<u>Hausman Statement</u>"), at 4.

increasing rates in adjacent monopoly markets.[8] While the LECs would have the Commission believe that any LEC rate that is lower than it would otherwise be must necessarily be "in the public interest," in fact, selective, anti-competitive short-term reductions in certain rates that are offset by rate increases where no competition is present will actually work to prevent the development of long-term sustainable competition.[9]

Therefore, the Commission should reject BellSouth's attempt to minimize what are entirely legitimate concerns about anticompetitive behavior. BellSouth contends that predatory pricing is an unrealistic outcome because of the technological and economic structure of the telecommunications market, and states further that once a competing network has been built an incumbent firm cannot expect to be able to price to prevent a competitor from reentering the market if the LEC raises its prices.[10] For the reasons discussed in more detail below, TW Comm does not share BellSouth's sanguine outlook on LEC behavior in an environment of increased pricing flexibility.

BellSouth would have the Commission consider an excessively narrow view of anticompetitive behavior, namely, a legal definition of predatory pricing. Although predatory pricing may be hard to prove, the risks associated with cross-subsidization by a company that offers both monopoly and

---

[8] Because the overall cost structure of the LECs is declining, the LECs can engage in a form of cross-subsidization that is hard to detect, since it is based on selectively passing through the effects of their cost reductions. LECs can target price reductions in their competitive services while holding the prices of their monopoly services constant.

[9] Comments of MCI ("MCI"), at 17.

[10] Hausman Statement, at 8 - 10.

competitive services are well-recognized. Even if the LECs are not successful in driving new entrants completely out of the market, there are certainly other significant dangers associated with excessive pricing flexibility being granted prematurely to LECs. Simply because competitors are not forced to leave the market does not mean that no harm has been done. Less robust competition means that prices will be higher, service diversity will be less, and consumer choice will suffer.[11]

Although the LECs may espouse support for competition in the local market, their financial incentives as well as their behavior flies directly in the face of their words. Therefore, absent compelling incentives to comply, LECs can be expected to

---

[11] Experience in Canada suggests that incumbents' ability to thwart entry by potential competitors poses a serious financial threat to new entrants. Unlike its United States counterparts, Unitel Communications, Ltd., the principal interexchange carrier (IXC) competitor to the consortium of Canadian telephone companies known as Stentor, has faced an uphill battle in entering the Canadian long-distance market. On January 2, 1996, AT&T announced that it was writing off or writing down some $1.1-billion to reflect the erosion of economic value of various business ventures, including $150-million of its investment in Unitel. See In AT&T's Attic, $1-Billion of Flops and Fumbles, N.Y. TIMES, January 4, 1996, at D1. There is no intrinsic reason why a Canadian IXC such as Unitel should be any less profitable than one of its United States counterparts, and thus its lack of success in the Canadian long distance business must be attributed to anticompetitive conduct and perhaps to predation on the part of the incumbents. (Unlike the post-MFJ industry structure in the United States, where the local telephone operators are not permitted to offer long distance services, the Canadian LECs through their Stentor consortium can and do offer local and long distance service on a fully integrated basis.) It appears that high access charges and other impediments to competition have prevented Unitel from becoming profitable. Similarly, any evaluation of the success of new entrants in the United States local market should explicitly take into consideration the efforts of the incumbent LECs to thwart such entry via terms, conditions, and prices of interconnection.

delay and frustrate efforts by others to enter and compete in their currently dominated markets. As noted by the Association for Local Telecommunications Services ("ALTS") it has been nine years since the Commission was first petitioned to require LECs to provide expanded interconnection, yet most of the tariffs are still under investigation.[12]

There are any number of other examples of LEC actions to inhibit competition despite facial claims of support for competition in principle. For example, Cincinnati Bell has been aggressively contesting the entry by TW Comm into local markets in Ohio despite the Ohio PUC's removal of regulatory barriers via its grant of TW Comm's application for certification.[13] Another example has been TW Comm's disappointing experience with Ameritech, another company that has been perceived by many as leading the other RBOCs in its alleged support for competition in the local market. TW Comm has been negotiating with Ameritech for more than twelve months on the terms and conditions for interconnection in Ohio and, at one point during these negotiations, Ameritech unilaterally terminated the discussions. Most recently, Ameritech has refused to make an interconnection agreement available to TW Comm in Ohio that is similar to those that Ameritech offers in Illinois and Michigan. Furthermore, even after state commissions have issued orders requiring interconnection, Ameritech has denied economically viable interconnection, requiring additional litigation and subsequent

---

12 Comments of the Association for Local Telecommunications Services ("ALTS"), at 4.

13 CBT petitioned the Public Utilities Commission of Ohio ("PUCO") to reconsider its certification of TW Comm, and, after that petition was denied, it appealed to the Ohio Supreme Court to rule whether the PUCO has authority to introduce local competition in the state. See TELECOM. REPORT DAILY, December 19, 1995.

PUC rulings directing compliance.[14] Moreover, TW Comm and other potential competitors seeking expanded interconnection arrangements have extensively documented how LECs have attempted at every opportunity to include provisions in their virtual collocation tariffs that prevent interconnectors from establishing themselves as viable competitors in the local market. The worst offender, Southwestern Bell Telephone, has used every means available to undermine the Commission's policies on expanded interconnection. It has blatantly imposed terms and conditions for virtual interconnection that make it as difficult and costly as possible to interconnect.[15]

These and other stonewalling tactics of the LECs demonstrate a willingness on the part of at least some incumbents to impede competition unless they are compelled by regulators (if necessary with sanctions) at each and every step of the way toward the elimination of barriers to entry. It also confirms that claims of facial compliance with specific items on a checklist will require far more than a "we trust you" response by the Commission; it will require full-scale investigation and

---

14 See Case No. U-10647 - In the Matter of the Application of City Signal, Inc. for an Order Establishing Interconnection Arrangements with Ameritech Michigan, (Michigan PSC October 3, 1995). The Michigan PSC upheld the conclusion of its Staff that as a result of Ameritech Michigan's repeated failure to file tariffs that complied with the Commission's order, "five months after the issuance of the Commission's Order, there has been no resolution of one of the most fundamental and significant facets of the interconnection arrangement — the interconnection of the unbundled loop." Id., at 3. Ameritech Michigan was expressly ordered to file tariffs that complied with the PSC's previous ruling or face potential sanctions. Id., at 14.

15 TW Comm Opposition to Direct Cases, CC Docket No. 94-97, Phase I (filed April 4, 1995) and Phase II (filed November 9, 1995).

opportunity for affected competitors to advise the Commission as to whether actual and practical compliance has been achieved.

Premature relaxation of the FCC's price cap system will simply reduce the incentives for LECs to eliminate barriers to competition. As Teleport correctly observed, should the LECs receive the substantial price cap relief that the FCC proposes, the Commission will lose leverage encouraging the LECs to implement pro-competitive policies.[16] TW Comm concurs with the National Cable Television Association that the Commission should condition any modifications to the price cap plan that are beneficial to the LECs upon compliance with a competitive checklist.[17] Finally, as noted by ALTS, there is substantial unused pricing flexibility under the existing price cap system.[18]

The fundamental uncertainty of the road to competition presents formidable risks in expanding the scope of existing pricing flexibility, as the LECs seek to do. Arguably, failure to provide LECs with the tools to compete could result in market share losses that might otherwise not have occurred. On the other hand, expansion of pricing flexibility would almost surely enable the LECs to eradicate nascent competition before it is given the opportunity to become firmly established. While there are risks of policy error on both sides, it would seem that the risk of imposing certain limited competitive losses on the incumbents pales by comparison with the risks arising from giving the incumbents the tools to eliminate competition from the outset.

---

16 Comments of Teleport Communications Group ("Teleport"), at 5.

17 Comments of National Cable Television Association ("NCTA"), at 11.

18 ALTS, at 3-6.

Indeed, it is simply unreasonable for LECs to expect to retain their present near-100% market share once actual competition begins. While Cincinnati Bell may express concerns about confronting LECs with "disincentives" to increase their market shares, that possibility is surely moot when market shares start out at 100%! It would be both improper and extremely short-sighted for the Commission to evaluate LEC requests for increased pricing flexibility as a means for preserving existing LEC market shares in the face of competition, in that any policy whose intent or effect is to protect a total monopoly from any competitive losses cannot possibly hope to produce a competitive marketplace. TW Comm is not here suggesting that the Commission should affirmatively handicap LECs from responding to competitors, only that the relative risks associated with a policy that might in the end result in modest LEC market share erosion must be seen as far smaller than the risks attendant to a policy that seeks to protect LEC market share from any and all losses whatsoever.

II. DEVELOPMENT OF THE COMPETITIVE CHECKLIST IS USEFUL BUT NOT DISPOSITIVE.

Telecommunications policy should be anchored in reality rather than based upon expectations of market changes. Although it is useful and appropriate to develop a competitive checklist in order to evaluate generally the ease of entry into the market, there are many complexities associated with any one of the items on the checklist that could determine whether barriers have truly been eliminated (e.g., the actual rates, terms and conditions associated with interconnection).[19] Because of the importance of

[19] See TW Comm Comments, at 29-39 for a detailed discussion of this point. See also Comments of Sprint Telecommunications Venture, at 10 which state that "[a]ny such checklist should (continued...)

a competitive checklist and the challenge of crafting such a list, TW Comm recommends that the Commission issue a further NPRM to more carefully hone such a list. However, although the checklist is a useful interim barometer for evaluating competitive conditions (and for evaluating LECs' progress in eliminating barriers to entry), even the best of checklists should not be relied on exclusively in order to gauge actual changes in the marketplace.

Under the second level of deregulation proposed in the FNPRM, the Commission would streamline regulation if LECs are able to demonstrate substantial competition for the particular service in a given geographic market. One of the ways that the Commission proposes to evaluate the competitiveness of LEC markets is to evaluate the LECs' progress in removing barriers to entry. In its initial comments, Southwestern Bell asserts that the checklist items relating to local exchange competition have no bearing on the degree of competition in access markets, and contends further that it does not take local competition to make transport services competitive.[20] While at first blush addressing barriers to local competition such as number portability would appear to be unrelated to the competitiveness of transport services, in fact, as a result of the substantial joint costs associated with the LECs' provision of both local and access services, the degree of competition in the local market

---

[19](...continued)
require proof, not just of the removal of entry barriers, but of the presence of effective competition in the market." <u>See also</u> Comments of AT&T ("AT&T"), at 16-17 which states "any showing offered to support reduced regulation must include specific measurements which confirm the actual presence of substantial facilities-based competition in the relevant product and geographic market."

[20] SWB, at 52.

does affect the degree of competition in the interstate transport market.[21] As MCI aptly states, "[w]ithout the ability to provide the full range of services offered by the LEC — local service, intrastate access, and interstate access — new entrants will be less likely to achieve the scale and scope economies to compete against the LECs."[22] Furthermore, the access market consists of substantially more than transport services and simply because transport may be facing some competition in certain markets, this does not mean that the entire special and switched access markets are competitive.

III. MARKET SHARE NOT ADDRESSABILITY IS THE ONLY RELIABLE INDICATOR OF COMPETITIVE MARKETS.

A. Market Share Is A Primary Indicator Of The Presence Of Competition.

One of the economic works that the Commission cites in the LEC Pricing Flexibility NPRM[23] includes an illustration of (1) how what may appear to be an easy market to enter may indeed have unexpected barriers, and (2) the importance of evaluating actual rather than potential entry into a market:

> There are several studies of the effects of concentration on fares between city pairs since the airline industry was deregulated. The airline industry would appear to have low costs of entry between city pairs for airlines already in operation. All that is needed is to fly a plane from wherever it is to the new origin and destination pair. That is, the airline industry appears to be a contestable market. Despite the

---

21 See TW Comm, at 42-50 for a more detailed discussion of this point.

22 MCI, at 22.

23 See FNPRM, para. 107-110.

> apparent ease of entry, however, studies of the airline industry consistently show that concentration in a city-pair market does influence fares. Actual entry, not potential entry, is critically important in influencing airline fares.[24]

As noted by the authors, there may be various interpretations of this scenario such as the limited number of gates, landing slots, and take-off slots at congested airports that limit the ease of entry. The presence of extensive "network externalities" which encouraged the formation of "hub" airline route networks may well be the primary explanation, because the ability of a given airline to profitably operate any particular city-pair route is critically dependent upon its ability to carry passengers to and from other destinations via the hub.[25] This example illustrates (1) the fallibility of the "competitive checklist" and (2) the importance of relying on actual changes rather than speculative ones in order to evaluate the competitiveness of a market.[26]

---

[24] Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization, Second Edition, Harper Collins College Publishers at 356, (footnote omitted, emphasis added).

[25] Dr. Lee L. Selwyn, Assessing Market Power and Competition in the Telecommunications Industry: Toward an Empirical Foundation for Regulatory Reform, 40 FED. COM. L.J. 193 (1988); ETI and Hatfield Associates, Inc., The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, February 1994 at 41-59; Dr. Lee L. Selwyn, Efficient Public Investment in Telecommunications Infrastructure, LAND ECONOMICS, August 1995, at 331-342.

[26] Indeed, it is not at all clear that the architects of airline deregulation understood the critical role that network externalities would play in limiting the extent of actual competition in individual city-pair routes, because regulators directed their attention primarily at the more obvious entry barriers — gate space, landing slots, and route authorities — the counterparts (for the airline industry) of the items of the FCC's proposed "checklist" for local competition.

With the exception of NYNEX,[27] the LECs oppose reliance upon market share as a basis for evaluating their market power. Southwestern Bell contends that it is "dangerous and inappropriate to rely on market share" in order to measure market power because (1) market shares may not be properly defined or calculated and may be based upon improper market definitions, and (2) although a low market share indicates that a market is competitive a market in which one or more firms have "high" market shares may or may not be competitive.[28] SWB also portrays market share as possibly a "legacy of the past regulation."[29] Cincinnati Bell argues that market share tests create perverse incentives — the incumbent may be reluctant to increase its market share because the increase would cause the imposition of more stringent regulatory rules.[30] Similarly, Pacific Bell contends that a finding of non-dominance should not be based on a minimum market share held by competitors.[31]

USTA proposes "a conservative measure of competition that focuses on the proportion of demand in a relevant market area that is addressable by alternative providers." According to USTA, "[u]nlike market share, addressability is a forward-looking indicator that seeks to determine if customers have alternative choices."[32] USTA also contends that:

---

27 NYNEX recommends, among other things, that streamlined regulation would apply to specific services in geographic areas where the CLECs had achieved 15 percent or more of the demand for the service in that market. NYNEX, at 7 and 43.

28 SWB, at 65.

29 SWB, at 66.

30 CBT, at 13 and USTA, at 50.

31 Hausman Statement, at 3.

32 USTA, at 49.

> Market share as a criterion predetermines the outcome of competition since it reserves a certain portion of the market for competitors before the incumbent is permitted to respond. As a result, customers do not receive the full benefits of vigorous competition, particularly if the established exchange carrier rate is used as a price umbrella for new entrants.[33]

Aside from raising interesting philosophical questions, (such as, whether it is possible to have competition without competitors or whether a service offering can be truly competitive if no customer chooses it?), these formulations have questionable practical significance, as shown below.

Southwestern Bell asserts that "[t]he presence of alternative supply indicates the lack of barriers to entry."[34] However, this overly simplistic view of the market fails to provide much guidance to the Commission. SWB fails to define "presence". For example, one could argue that TW Comm is "present" in the Ohio market, yet CBT persists in its efforts to oppose TW Comm's entry, true number portability is not available, reasonable arrangements for mutual compensation do not yet exist, etc., and thus TW Comm cannot yet operate efficiently in this local market. In fact, unless these interconnection issues are resolved, TW Comm cannot operate at all despite its "presence". Thus the fact that TW Comm is certified to offer service is meaningless unless there are reasonable terms and conditions for interconnection with the incumbent.

---

[33] Id., at 53.

[34] SWB, at 68.

B. Addressability Is a Flawed Concept.

As the LECs see it, entry is possible and markets become addressable once all legal and operational barriers to competitive entry are removed. Under this construct, it is not necessary to affirmatively demonstrate that actual competition has developed; all that need be shown is that all relevant, identified entry hurdles within the LECs' control have been removed. This can be accomplished by merely examining the conditions for entry and the status of identified barriers. The Commission need only go down a "checklist" of issues, show that each has been addressed, and actual competition can be presumed to exist. And, so this argument goes, if actual competition is present — even presumptively — consumers no longer require regulatory protection against excessive prices by the incumbent LEC, and the incumbent LEC must be allowed to fully compete with its new rivals without being burdened by artificial pricing constraints. What is particularly troubling about this line of reasoning is that the LECs fail to acknowledge the significance of eliminating the barriers to local competition for either the first or second levels of lessened regulation proposed by the Commission, but only recognize its relationship to the LECs' pursuit of nondominant status.

To be sure, elimination of an enumerated list of entry constraints is a threshold condition for competition but the mere removal of those barriers that happen to appear on the "checklist" does not in and of itself assure that competition will develop. For one thing, the items contained on the checklist are by their nature set forth at a very high level and thus cannot possibly contemplate and resolve all ongoing day-to-day issues that can affect a new entrant's ability to compete. It is not sufficient simply to ascertain that the items on the checklist have all been resolved; rather, it is necessary to establish that the checklist itself is sufficiently complete and comprehensive so as to correctly identify and eliminate all relevant artificial entry constraints. From the LECs' perspective, their compliance with regulatory mandates to remove remaining entry barriers makes all affected markets addressable, and justifies the LECs' actions in responding to all such competitive inroads. As the LECs see it, once competition is nominally permitted, they should be free to exploit all of their operational efficiencies and to preserve and protect their market position. The presence of a unique operational efficiency, one that for example results from the LECs' unique ability to integrate the production and delivery of competitive services with its core monopoly service infrastructure, is seen as an advantage to be exploited rather than as a essential facility to be offered on a nondiscriminatory basis to the LECs' rivals.[35] If the LECs turn out to be the most efficient provider (which the LECs frequently contend and which may well be the result if LECs are not required to make access to their networks available to competitors on a nondiscriminatory basis), they ought to be allowed to present economic signals (prices) to the marketplace that reflect such efficiencies, even if such prices fall below their competitors' costs.[36] Under this theory, downward pricing

---

[35] See Pacific Companies, Appendix (hereinafter "Kahn- Tardiff Report") at 8-10. Prof. Kahn's extraordinarily narrow view of "essential facilities" would deny competitors access to many LEC network resources that cannot reasonably be replicated by the new entrants, and would sanction — indeed, even encourage — LECs' efforts to exploit these unique operational advantages even if the result would be to eliminate competitors altogether.

[36] This result is pre-ordained by the economic "theories" being put forth by LEC consultants. If competitors cannot feasibly replicate LEC network resources which (under the unduly narrow view being expressed by Kahn) are not per se (continued...)

flexibility is thus in the public interest whether or not competition is present, because it will permit LECs to bring their rates closer to cost.

In effect, the LECs adopt the notion that, if all of the items on the list are addressed and competition still fails to develop, it is not because competitors were denied the opportunity to compete but because the LECs are simply more efficient than their smaller rivals. To be sure, that is one possible explanation but it cannot be the correct one. Indeed, while LECs may persist in their belief that they are more efficient than any new entrant, such a presumption runs counter to the very underpinnings of the Commission's regulatory policies. By relying on competition to ultimately supplant some or all regulation, the Commission has already determined that competition is economically capable of developing and surviving; the Commission has, in effect, concluded that new entrants are no less efficient than incumbent LECs, and that they can viably compete with the LECs <u>despite the latter's size and overall scale of operations</u>. Thus, if competition fails to develop in a particular market segment, it must be concluded that the threshold elimination of artificial entry barriers or the establishment of appropriate constraints on LEC market power have not been fully achieved.

It is thus not sufficient merely to satisfy each (or even all) of the items on a checklist, because that does not by itself establish the sufficiency of the checklist in eliminating all relevant entry hurdles. Ultimately, the only really accurate

---

[36](...continued)
"essential facilities," competitors would by definition be forced to incur stand-alone replication costs that would almost certainly exceed the incremental costs confronted by the LECs.

means for assessing the validity of such a checklist is to measure its effectiveness in permitting actual competition to develop and prosper. If effective competition at a level sufficient to constrain the incumbent's market power is present, then the checklist can be presumed to be complete and to have been fully met. Conversely, the absence of effective competition must be interpreted as dispositively indicating that (a) the checklist is not comprehensive in addressing all relevant entry barriers, and/or that (b) the LEC has not actually complied with some or all of the items on the checklist, irrespective of any evidence of nominal compliance with individual items that the LEC may have offered to the Commission.[37]

While one can presume that competition for local exchange carrier services is economically viable (because such an assumption lies at the core of current national telecommunications policy), one cannot presume that competition will develop merely because legal and economic barriers are lifted because, a priori, one cannot be certain as to precisely what all such barriers are and precisely where and how they operate. That can only be learned from actual experience with entry and competition, and must be tested empirically based upon actual results and not just theory.[38]

---

[37] The New York Public Service Commission, for example, has recognized the need to determine whether effective competition has emerged under its newly enacted regulatory plan for New York Telephone Company. The Commission imposed a three-year competitive checkpoint to analyze the state of competition and make necessary changes to the regulatory structure. Case No. 92-C-0665 - Opinion and Order Concerning Performance Regulatory Plan, Opinion No. 95-13 (NYPSC August 16, 1995).

[38] In some major jurisdictions, legal bars to competitive entry have been gone for nearly a decade, yet incumbent LEC market shares remain close to 99%. See Trends in Telephone Service, Common Carrier Bureau, February 1995.

TW Comm concurs that supply elasticity is a legitimate criterion, but for the reasons detailed in its initial comments, recommends that (1) supply elasticity be considered as only one of several relevant factors for evaluating the competitiveness of a market, and (2) the Commission recognize the essential and highly relevant point that the mere presence of facilities and capacity owned and controlled by potential competitors does not constitute an elastic supply if barriers such as lack of number portability persist. So long as there are barriers to entry such as the lack of number portability and just and reasonable terms for interconnection, the apparent possibility of entry is an unreliable indicator of competition in the marketplace. The Commission should reject the LECs' plea to evaluate the competitiveness of a market based upon "addressability" considerations.

C. LEC Promotion Of "Addressability" Is Inconsistent With Their Posture Regarding Competitiveness Of Interexchange Markets.

Although LECs are eager to apply "market contestability" theory to local markets, this theory is conspicuously absent as they develop their own claims as to the lack of competitiveness of the interexchange carrier (IXC) market (which, they claim, their entry into interLATA toll services would somehow remedy). In a recently-released "study" by LEC consultant Paul W. MacAvoy, IXC market concentration is measured not in terms of "addressability" or "contestability" but on a more traditional, market share basis utilizing the Herfindahl-Hirschman Index (HHI) of industry concentration.[39] Application

---

[39] Paul W. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Markets for Long-Distance Telephone Services, Prepared for The American Enterprise Institute for Public Policy Research, at 107-169 (November 1995).